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IN THE

# Supreme Court of the United States

October Term, 1943.

No. 510

Wilson Milling Company, a dissolved corporation, by A. J. Landrum, R. E. Lee Wilson, Jr., J. H. Crain, S. A. Regenold, and W. F. Wilson, Trustees in liquidation, *Petitioner,*

v.

Commissioner of Internal Revenue, *Respondent.*

**Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.**

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WILSON MILLING COMPANY, a dissolved corporation, by A. J. Landrum, R. E. Lee Wilson, Jr., J. H. Crain, S. A. Regenold, and W. F. Wilson, Trustees in liquidation, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

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**Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.**

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The petitioner, Wilson Milling Company, a dissolved corporation, by A. J. Landrum, R. E. Lee Wilson, Jr., J. H. Crain, S. A. Regenold, and W. F. Wilson, its trustees in liquidation, prays that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Eighth Circuit entered in the above entitled cause on October 18, 1943.

## OPINIONS BELOW.

The opinion of The Tax Court of the United States (R. 13-20) is reported at 1 T. C. 389. The opinion of the Circuit Court of Appeals (R. 30-34) has not, as yet, been officially reported.

## JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on October 18, 1943 (R. 35). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED.

Is petitioner liable for unjust enrichment tax in 1937 on the sum of $3,794.92 received by it in that year as reimbursements of processing taxes paid by it in 1935 in the purchase of flour (the burden of which tax was shifted to petitioner by its vendors), when petitioner in each of the years 1935, 1936, and 1937 sustained net losses in excess of said amount?

## STATUTE INVOLVED.

The statute involved is the Revenue Act of 1936, Sections 41, 43, 501, and 503(a), the pertinent parts of which are printed in the Appendix, *infra*, pp. 13-15.

## STATEMENT OF THE CASE.

The Wilson Milling Company, hereinafter referred to as petitioner, was an Arkansas corporation organized in 1930 to engage in the wheat and corn milling business at Wilson, Arkansas. It was dissolved in 1938 and its directors became liquidating trustees to wind up its affairs. Petitioner filed its federal tax returns with the collector for the dis-

trict of Arkansas. (R. 14.) It kept its books and filed its tax returns on the accrual basis of accounting.[1]

In 1934 petitioner discontinued the milling of wheat and thereafter bought flour in the open market from other milling companies and sold it to its customers. It continued the milling of corn into meal, but its business was not successful and it ceased operations in 1937. Its books and records were left in the office in the vacant mill building. The office was later broken into by unknown persons and the books and records were scattered, burned, and destroyed. (R. 14.)

During 1935 petitioner purchased flour from millers under contracts known as "Miller's National Federation Uniform Sales Contract (adopted July 10, 1934)," which contracts contained the following provision:

> Taxes: The price named in this contract includes all taxes as at the date hereof proclaimed by the Secretary of Agriculture by virtue of the authority vested in him by the Agricultural Adjustment Act of the United States. * * * if any tax included in the price hereof shall be decreased or abated, then, in that event, said decrease or abatement shall be deducted from the price hereof. (R. 12-13, 14.)

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[1] At the oral argument before the Circuit Court of Appeals petitioner argued under its fifth assignment of error (R. 23) that the decision of the Tax Court was wrong for the additional reason (not before advanced) that petitioner was on the accrual basis. Therefore, the reimbursements in question, if income at all, accrued in 1936. In that year the provision in petitioner's contracts for tax adjustments (R. 14) ripened into a fixed claim following this Court's decision in *United States* v. *Butler*, 297 U. S. 1. The evidence before the Tax Court showed that petitioner was on the accrual basis, but this particular evidence was not part of the record before the Circuit Court. Petitioner, therefore, asked leave of the Court to have a certified copy of this evidence sent up to be made a part of the record on appeal, and understood that its request was granted. Thereafter, a certified transcript of this particular evidence (set out on pages 12 to 13 of the Appendix) was forwarded to the Clerk of the Circuit Court, but petitioner was advised later that it was not filed. Accordingly, petitioner has attached the evidence to its petition and has assigned error because of the Circuit Court's failure to receive the evidence and consider the question.

On January 6, 1936, the Agricultural Adjustment Act, which imposed the processing taxes, was held invalid. *United States* v. *Butler,* 297 U. S. 1. Thereafter in 1937, and pursuant to the aforesaid agreement, petitioner's vendors refunded to petitioner the sum of $3,794.92. (R. 14.)

Petitioner purchased the flour in 1935 at a certain price per barrel which included the processing tax, as stated in the aforesaid contracts. Petitioner sold the flour at a certain price per barrel and made no separate charge or entry for the tax. Petitioner's cost price in each instance was the price paid under the aforesaid agreements. (R. 15.)

Petitioner sustained losses on the sale of all flour which it purchased and resold (R. 11-12), and it sustained losses on its operations as a whole in each of the years 1935, 1936, and 1937 in the respective amounts of $11,436.81, $4,554.40, and $8,677.06 (R. 15). It reported these losses in its income tax returns filed for said years (R. 15). It filed an unjust enrichment tax return for 1937 and reported therein no unjust enrichment income for 1937 (R. 9, 14).

Although petitioner sustained a net loss of $8,677.06 in 1937 (after including the 1937 reimbursements of $3,794.92), the Commissioner of Internal Revenue determined that petitioner had unjust enrichment income to the extent of the reimbursements, and asserted an unjust enrichment tax thereon of 80 per cent, or $3,035.95 (R. 7-9, 15). The Tax Court affirmed the determination of the Commissioner (R. 13-21) as did the Circuit Court of Appeals (R. 30-35).

## SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court erred as follows:

1. In holding that petitioner had unjust enrichment income when it lost money on its overall handling of the product (flour) from which it received the reimbursements.

2. In holding that petitioner had unjust enrichment income when, in each of the years 1935, 1936, and 1937, it had

losses which exceeded the amount of the reimbursements here involved.

3. In holding that petitioner had unjust enrichment income from reimbursements when the prior deduction (as cost of goods sold) of the amounts refunded did not result in a tax benefit to petitioner.

4. In failing to hold that the reimbursements received by petitioner were either paid under contract and were therefore a reduction in the purchase price, or were not paid under contract and were therefore nontaxable gifts.

5. In failing to allow petitioners to argue a new issue when all the facts necessary for a consideration of the issue were proved in the trial court.

6. In failing to receive and file a certified copy of part of the record in the trial court showing petitioner to have kept its books on the accrual basis of accounting.

7. In failing to hold that petitioner's right to these reimbursements accrued under its contracts in 1936 when the processing tax was invalidated and, if taxable income at all, the reimbursements are taxable income in that year.

8. In failing to hold that the reimbursements received by petitioner in 1937 should relate back to either 1935 or 1936 in order properly to reflect income.

9. In failing to hold Section 501(l) of the Revenue Act of 1936 invalid insofar as it purports to tax reimbursements under Section 501(a) (2) thereof when the taxpayer has no net income.

10. In holding that petitioner realized unjust enrichment income in 1937 from the reimbursements received by it.

## REASONS FOR GRANTING THE WRIT.

1. The decision below, holding that amounts paid to petitioner as reimbursements of the processing tax burden previously shifted to it were—

> taxable as income for the year 1937 *regardless of whether the petitioner was on a cash or an accrual basis* (R. 33-34; italics supplied),

is in conflict with *Helvering* v. *Cannon Valley Milling Co.*, 8 Cir., 129 F. 2d 642. That case holds that such refunds relate back to the year of the original transaction under Section 43 of the Revenue Act of 1934 (the pertinent part of which is identical to the same Section of the 1936 Act; Appendix, p. 14).[2]

This Court on October 11, 1943, granted a writ of certiorari in *Commissioner* v. *Security Flour Mills Co.*, 10 Cir., 135 F. 2d 165 (S. Ct. No. 276), to resolve a conflict between that case and the *Cannon Valley Milling Co.* case. Both of these cases deal with the time for deduction by vendors of reimbursements to customers, made after the invalidation of the processing tax. Petitioner herein as a member of the "customer" class has the counterpart of this problem, i. e. the time for inclusion in income (if income) of amounts received as reimbursements from such first processors.

Petitioner in 1935 bought and sold its flour "tax on" under the "Miller's National Federation Uniform Sales Contracts" (R. 14). In 1936 the processing tax was held

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[2] The Appellate Court's holding quoted above also fails to give effect to Section 41 of the Revenue Act of 1936 which is made applicable to unjust enrichment taxes by Section 503(a) of the same Act. Cf. also Section 501 (d) of the Act. (Appendix, pp. 13-15.) Section 41 provides in part that—

> The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *.

Since the cash receipts and disbursement method of accounting is entirely different from the accrual method of accounting, it is difficult to understand the failure of the Court below to respect this distinction.

to be invalid, and in 1937 petitioner received the reimbursements now in question. A somewhat similar situation is now before the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Blaine, Mackay, Lee Co.*, Nos. 8109, 8110, in which cases the Board of Tax Appeals held that attorneys' fees incurred in contesting the processing taxes related back to the year in which such taxes were originally incurred *for purposes of unjust enrichment tax as well as income tax.*[3]

The issue is open on all sides, and this Court should resolve the question not only as to the first processors but also as to their customers.

2. The Court below in discussing the reimbursements wrote as follows:

> It is not important whether the vendors who reimbursed the petitioner in 1937 were legally obligated to do so or not. * * * They [the reimbursements] were obviously, not gifts or returns of capital * * *. (R. 33).

If petitioner's right to these reimbursements could have been enforced under the Miller's National Federation Sales Contract (R. 14), the subsequent readjustment of the purchase price would seem properly to relate back to the date of purchase. If, then, this contract was enforceable, the opinion of the Eighth Circuit is in conflict with its own decision in *Helvering* v. *A. L. Killian Co.*, 128 F. 2d 433, and with decisions of the Sixth and Seventh Circuit Courts of Appeals in *Borin Corporation* v. *Commissioner*, 117 F. 2d 917, and *Hirsch* v. *Commissioner*, 115 F. 2d 656, respectively, holding that a reduction in the purchase price of property does not constitute income, but rather a change in the cost-basis of the property.

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[3] These opinions of the Board of Tax Appeals are not officially reported. They are found in 1942 Prentice-Hall Memo Service, Paragraphs 42,022 and 42,032.

On the other hand, if payment of these reimbursements could not have been required by law, then they must be "the receipt of financial advantages gratuitously". In this posture of the case, the opinion below, in holding these reimbursements were not gifts, is contrary to the recent holding of this Court in *Helvering* v. *American Dental Co.*, 318 U. S. 322.

3. The Court below upheld the constitutionality of Section 501(l) of the unjust enrichment tax law (Appendix p. 15), as applied to a taxpayer having a net loss for the year, by relying upon *United States* v. *Hudson*, 299 U. S. 498. It is submitted that the unjust enrichment tax, when so applied, is violative of the Fifth Amendment and is not sanctioned by the *Hudson* case.

The unjust enrichment tax is unquestionably an income tax. "Income", taxable under the Sixteenth Amendment has, since *Eisner* v. *Macomber*, 252 U. S. 189, 207, been defined as—

> * * * the *gain* derived from capital, from labor, or from both combined, provided it be understood to include *profit* gained through a sale or conversion of capital assets. * * * (Italics added.)

Obviously petitioner herein had no "gain" or "profit" since it lost money in 1935, 1936, and 1937 on all the flour it handled (R. 12) and on its operations as a whole (R. 15). In such a situation Congress indicated that it doubted its right to levy this tax. See the "except" clause of Section 501(l) of the Revenue Act of 1936 (Appendix, p. 15).

Furthermore, it is believed that the English Circuit has misconstrued the scope of the *Hudson* case in applying it to the facts at bar. That case involved a stamp tax (an excise tax imposed under Schedule A of Title VIII of the Revenue Act of 1926, as amended by the Silver Purchase Act of 1934) on the transfer of silver, which fact is apparent from the opinions of the Court of Claims in *Hudson* v.

*United States*, 12 F. Supp. 620, 13 F. Supp. 640.[4] The question before this Court on appeal of that case was the validity of the retroactive application of this stamp tax. In permitting the tax to be applied retroactively for 35 days this Court said:

> Thus a profit [on the sale of silver] is made the occasion for the tax and also the measure of it. Because of this, counsel for the government contend that the tax is a special income tax; and we think the contention is sound.

Perhaps, at this point the Court had in mind the case of *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, which upheld an excise tax on corporations doing business which tax was measured by net income. While not appearing in the opinions (as the Board admitted; R. 20), it may have been shown that the taxpayer in the cited case had a net taxable income for the year involved,[5] in which event the Court may have

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[4] The Treasury Department treats the stamp tax considered in the *Hudson* case as a "documentary stamp tax". In I. T. 2899, issued in 1935, and still in effect, the tax imposed by the Silver Purchase Act of 1934 was held to be deductible in computing income taxes. In Mim. 4587, Cumulative Bulletin 1937-1, p. 74, the same ruling was expressly adhered to *following* the *Hudson* case. If, however, this tax on silver profits were an income tax, this deduction would not be proper. The Revenue Acts of 1934 and 1936 provide in Section 23 (as the Treasury ruling points out) that in computing net income there shall be allowed as deductions:

> (c) TAXES GENERALLY.—Taxes paid or accrued within the taxable year, *except*—
>
> (1) *Federal income*, war-profits, and excess-profits *taxes* * * * (Italics added.)

Cumulative Bulletin XIV-1, p. 67.

[5] This was admitted in effect on page 4 of Hudson's brief in opposition to the petition for certiorari. Thus Hudson argues:

> * * * in the case of a taxpayer *like the respondent, having a statutory net income of over $100,000*, the tax on the silver profits involved in the present case would total 106% * * * (Italics added.)

*United States* v. *Hudson*, October Term, 1936, No. 97, Respondent's Brief in Opposition to Petition for Certiorari, filed July 18, 1936.

considered the stamp tax (measured by income) to be analogous to an excess profits income tax. Thus, if the taxpayer had income, Congress could impose an additional tax on it. In the absence of an affirmative showing, however, that the taxpayer in the *Hudson* case operated *at a loss* throughout the taxable year it would appear that the above quotation is *obiter dictum* as the Treasury Department, in effect, so held. Mim. 4587, *supra.* Since the situation in the case at bar (a net operating loss) was not considered by this Court in the *Hudson* case, that decision is hardly authority to support the holding below in the instant proceeding.

In any event the decision of the Circuit Court that Congress may single out a "particular type of income" (R. 34) and impose an *income* tax on it (regardless of the fact that the taxpayer lost money on its entire operations for the year) is so far-reaching as to warrant the consideration of this Honorable Court. If the *Hudson* case means what the Court below construed it to mean, then Congress can constitutionally tax the corner grocer on his gross income without allowing him a deduction for the cost of goods sold and even though he operated at a loss throughout the tax period. It is hardly believable that this Court in the *Hudson* case was overruling *Eisner* v. *Macomber* and other decisions holding that the right of Congress to levy income taxes under the Sixteenth Amendment is limited to cases where there are "gains" or "profits". Petitioner submits that the Sixteenth Amendment does not permit Congress to tax "net losses" under any guise.

4. At the oral argument in the Circuit Court petitioner contended that it was on the accrual basis and thereafter tendered to the Clerk of the Court a certified copy of part of the transcript below (not in the printed record) showing

that petitioner was on the accrual basis of accounting.[6] The Court apparently has not considered this contention and has not filed the additional portion of the record so certified. Such action was contrary to *Hormel* v. *Helvering*, 312 U. S. 552, in which case this Court held that the Eighth Circuit quite properly considered a new issue raised by the Commissioner of Internal Revenue. The issue in that case was advanced for the first time on appeal without an express assignment of error in the petition for review[7] and even though in that case all the evidence necessary for a final decision on the new issue had not been before the Board of Tax Appeals. Here all the material evidence on the issue was before the Board and was tendered to the Circuit Court. In the *Hormel* case this Court refused to sanction such a strict rule of procedure as that applied herein when to do so would result in "a plain miscarriage of justice." A like result is obviously reached by precluding the new issue in the case at bar. Cf. 9 Geo. Wash. Law Rev. 962.

## CONCLUSION.

It is respectfully submitted that this Court in considering the *Security Flour Mills* case should also review the instant proceeding so as to settle the comparable questions here involved pertaining to customers of the "first processors."

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November, 1943.

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[6] This fact was very material since, on the accrual basis of accounting, these reimbursements should be taxed, if at all, in 1936 when petitioner's contingent right to demand reimbursement under its contracts (R. 14) became absolute as a result of this Court's holding that the processing tax was invalid in *United States* v. *Butler*, 297 U. S. 1. *The Treasury Department so holds.* I. T. 3064, Cumulative Bulletin 1937-1, p. 94. Only if petitioner was on the cash receipts and disbursements basis would these amounts be taxable in 1937. *Schoellkopf Aniline & Chemical Works* v. *United States*, 77 Ct. Cl. 529, 3 F. Supp. 417; *Spring City Foundry Company* v. *Commissioner*, 292 U. S. 182.

[7] *Helvering* v. *Hormel*, 111 F. 2d 1, 3.